

# Presentation to the El Paso City Council

## Regarding Results of El Paso Electric Benchmarking



Presented by:

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### Project Background

- The City entered into a Rate Agreement with El Paso Electric Company effective July 1, 2005 which required the City to select an outside firm to determine whether the Company's operating expenses are within a reasonable range as compared to the utility industry.
- Navigant Consulting was retained by the City to perform the review of the Company's operating expenses. Work on the review was initiated in February 2006.

## Project Background

- The City directed Navigant Consulting to answer the following questions:
  - Are EPE's costs reasonable given its business structure?
  - Are EPE's operating and maintenance expenses appropriate given its operating environment?
  - Are there specific opportunities that emerge from the above analysis that EPE should pursue?

### Scope of Work

- Navigant Consulting reviewed all operating costs of the Company's regulated utility business. The costs were separated into four main components:
  - Generation
  - Transmission and Distribution ("T&D")
  - Customer Care
  - Corporate/support functions ("A&G")
  
- Excluded from the analyses were:
  - Fuel and purchased power expenses
  - Pensions and Benefits (Account 926)
  - Franchise Requirements (Account 927), and
  - Regulatory Commission Expenses (Account 928).

### NCI's Approach

- NCI relied upon publicly available data, as well as our internal databases, to assess the Company's operating costs. We reviewed the costs in aggregate, by FERC account, as well as on a unitized basis.
- NCI reviewed the Company's historical costs for the last four (4) years. A multi-year review allowed for the normalizing of expense levels
- NCI relied upon annual data for the Company and a selected peer group of companies as reported in Form 1 Annual Reports to the Federal Energy Regulatory Commission.

### Peer Group Selection Was Based on Five Factors.

1. **Company Type:** Companies selected are electric operating utilities required by FERC to file Form 1 (i.e., IOUs)
2. **Company Organization:** Holding companies with many operating utility subsidiaries were generally excluded
3. **Business Composition:** Companies selected are integrated utilities, with both generation and delivery operations
4. **Company Location:** Companies selected are primarily located in the Midwest or Southwest
5. **Company Size:** Companies selected have between 100,000 and 1,000,000 customers, annual retail revenues of \$200 million to \$2 billion, and under \$10 billion in net plant

**It is important to compare companies with similar size and organizational structure so as to provide a reasonable comparison.**

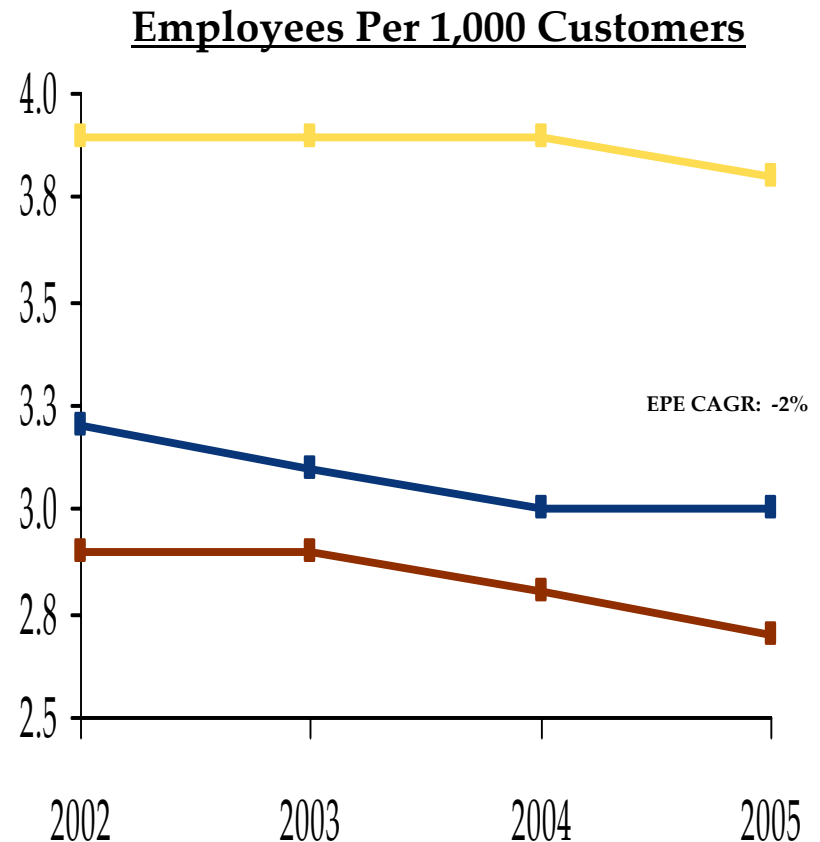
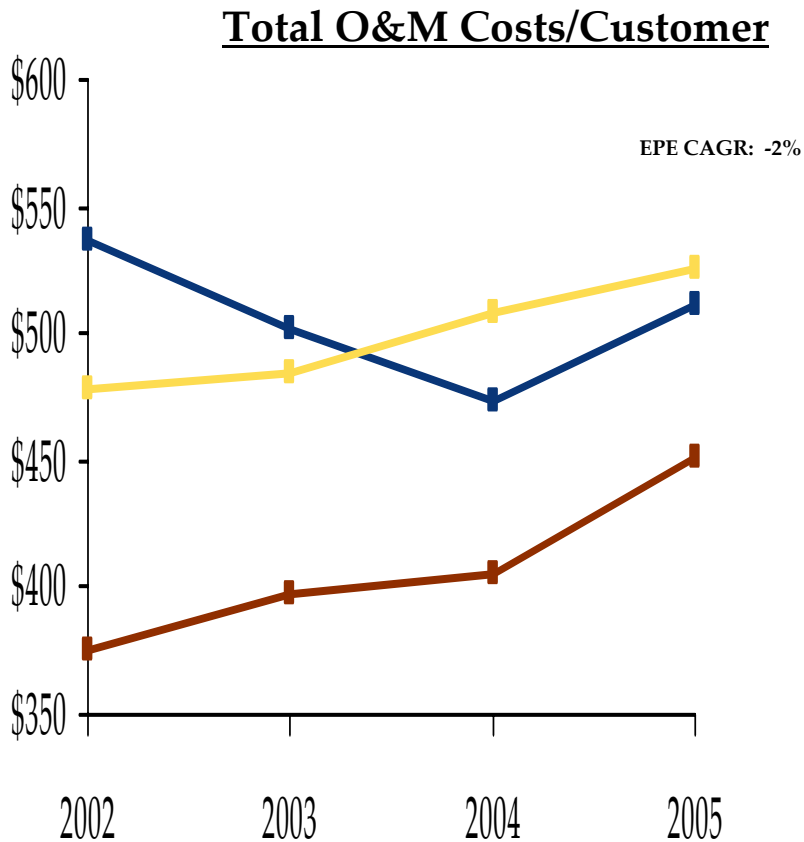
## Benchmarking Approach– Peer Group Companies

Based on the five factors a peer group of 20 operating utilities was chosen.

Peer Group Utilities (Ticker or Abbreviation)	
Arizona Public Service Co. (APS)	Madison Gas & Electric Co. (MGE)
CLECO (CNL)	MidAmerican Energy Co. (MA)
Dayton Power & Light (DPL)	Northern Indiana PSC (NI)
Duquesne Light Co. (DQE)	Oklahoma Gas & Electric Co. (OGE)
The Empire District Electric Co. (EDE)	Otter Tail Power Co. (OTTR)
Indianapolis Power & Light (IPL)	Public Service Co. of New Mexico (PNM)
Kansas City Power & Light (KCPL)	Tampa Electric Co. (TECO)
Kansas Gas & Electric Co. (KGE)	Tucson Electric Power Co. (UNS)
Kentucky Utilities (KU)	Westar Energy (WR)
Louisville Gas & Electric (LGE)	Wisconsin Public Service Corp. (WPS)

## Benchmarking Results– Overall Peer Group (2002-2005 Trends)

**EPE's total O&M costs and employees per customer have declined since 2002 and are above the peer group average.**



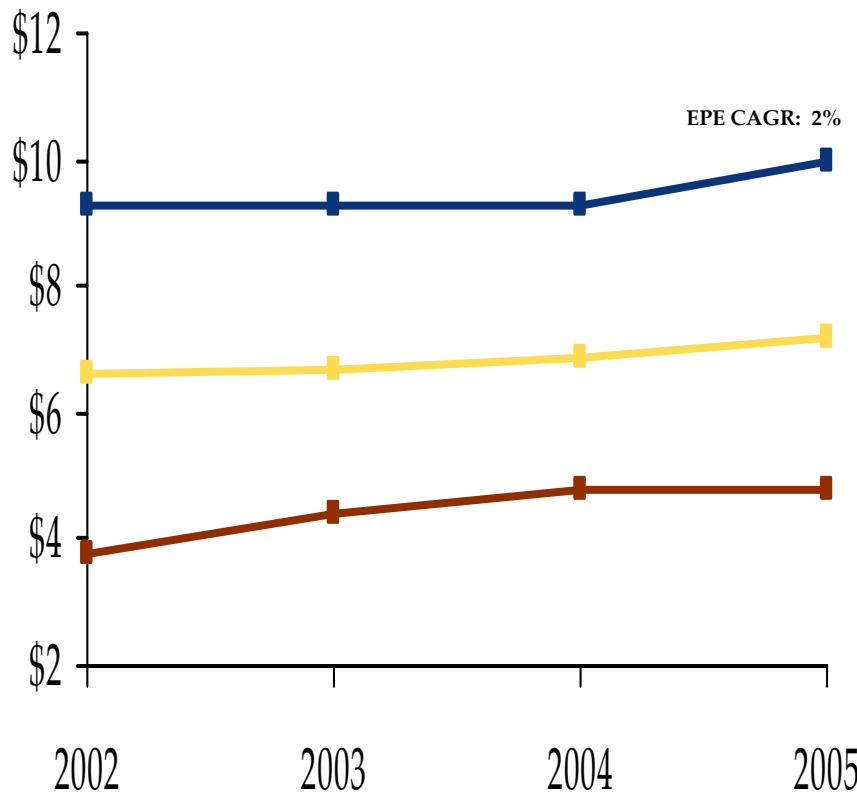


## Benchmarking Results– Overall Peer Group (2002-2005 Trends)

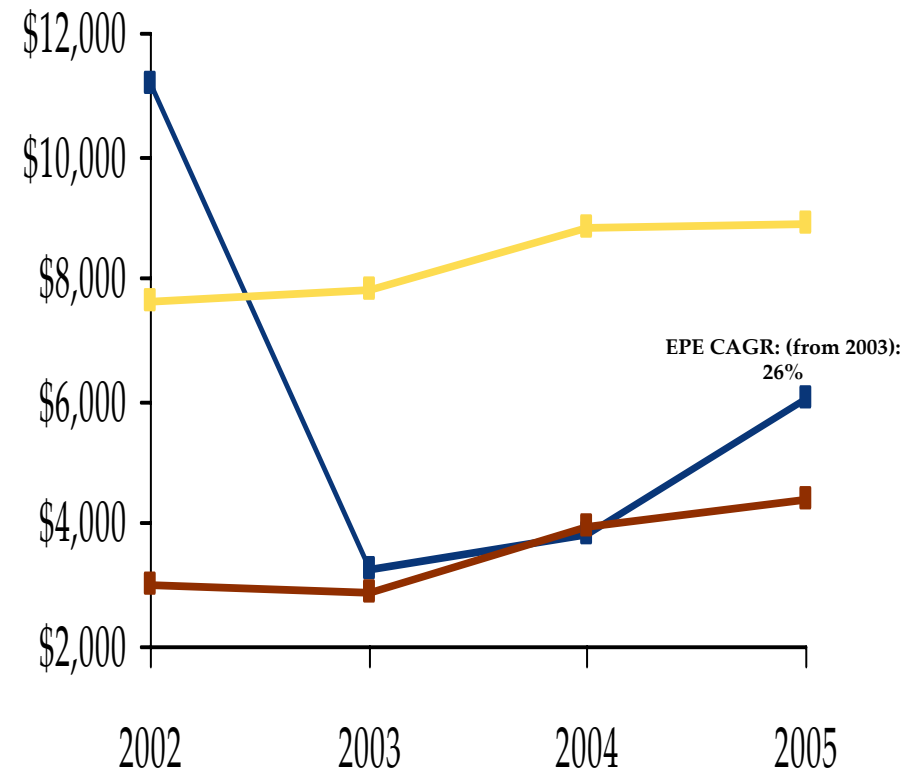
**EPE's generation costs are above the peer group average, while transmission costs are near top quartile.**

El Paso  
Average  
Top Quartile

Generation O&M/ MWh



Transmission O&M/Line Mile

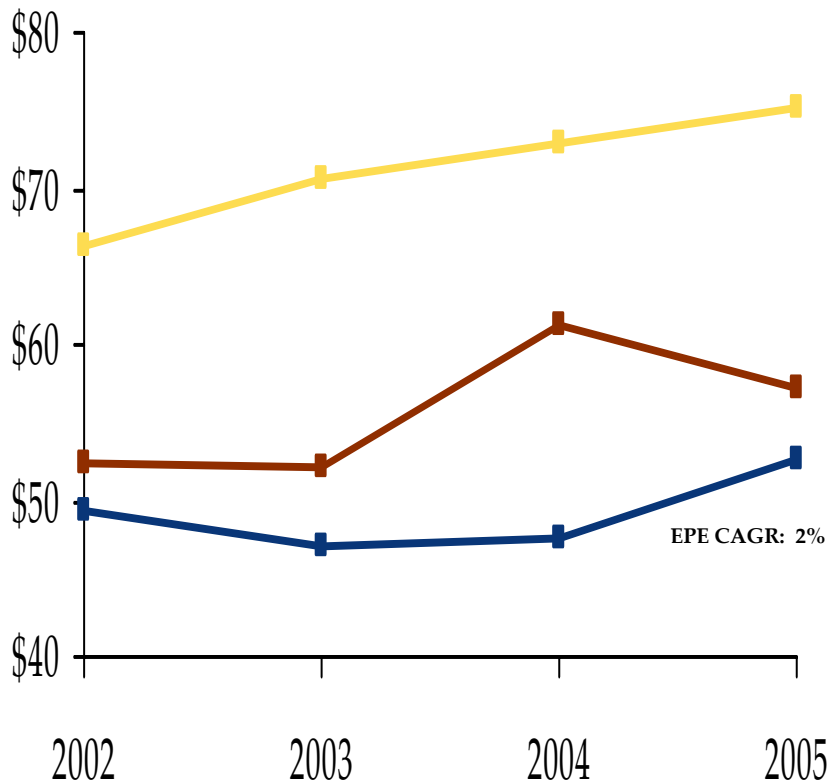


## Benchmarking Results– Overall Peer Group (2002-2005 Trends) (cont'd)

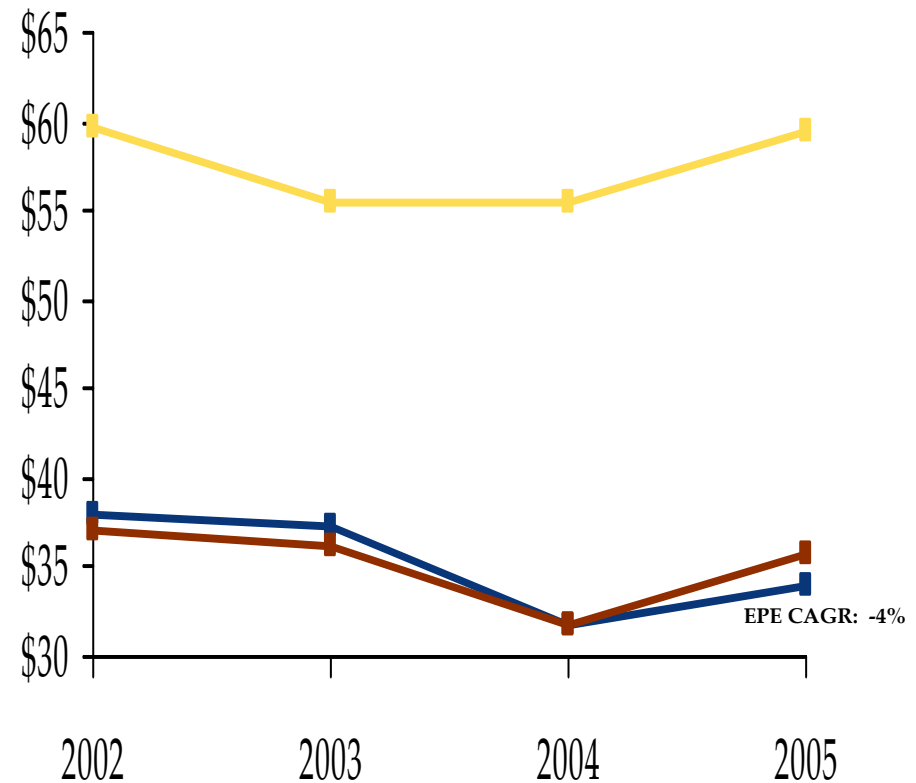
**EPE's Distribution and Customer Care O&M costs are less expensive per customer than top quartile.**

— El Paso  
— Average  
— Top Quartile

Distribution O&M/Customer



Customer Care Expenses/Customer

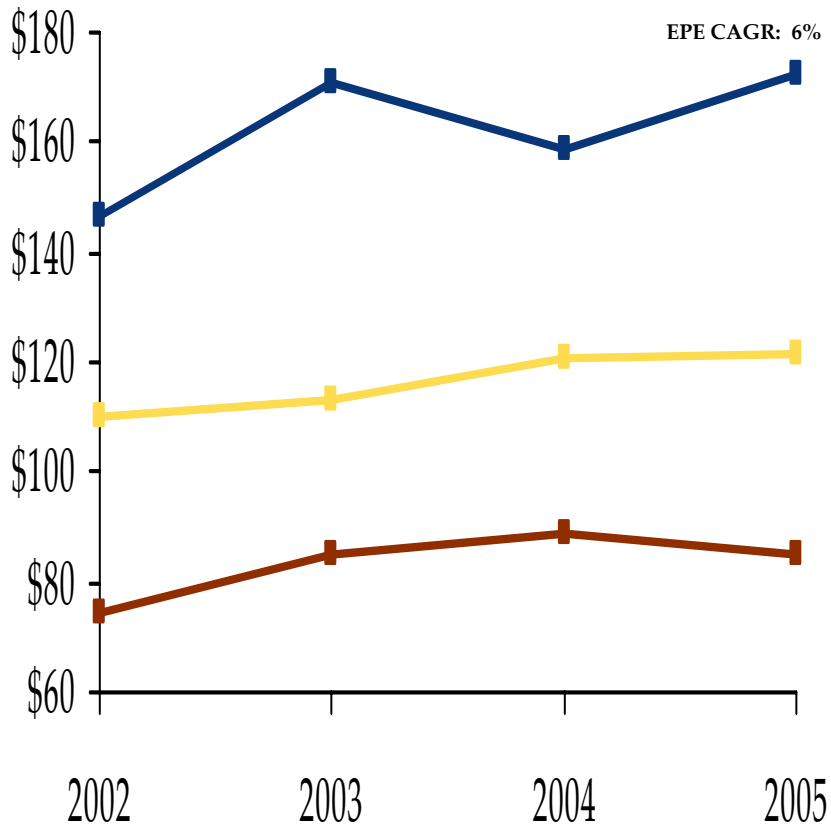


## Benchmarking Results– Overall Peer Group (2002-2005 Trends) (cont'd)

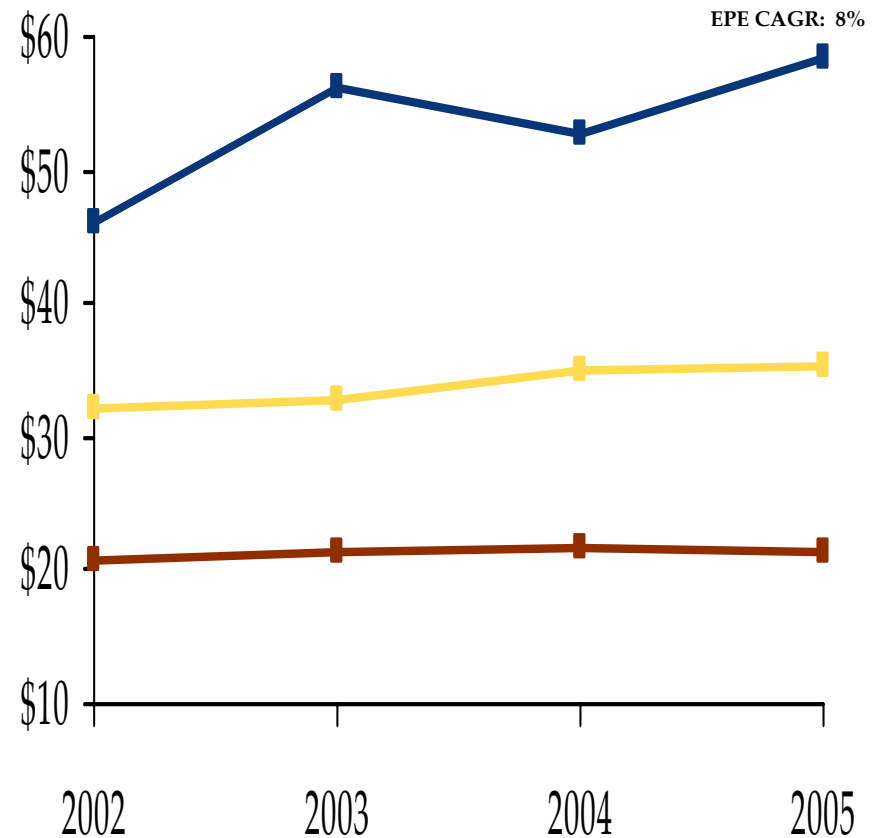
**EPE's A&G costs are high compared to the peer group.**

— El Paso  
— Average  
— Top Quartile

A&G Expenses/Customer



A&G Expenses (\$000)/Employee



Source: FERC Form 1, NCI analysis

## Generation—2005 Benchmark Summary

**EPE's Generation O&M costs were higher per MWh than the peer group average in 2005.**

### *O&M Generation Benchmarks-2005*

	EPE	Peer Group Average	Peer Group Top Quartile	Gap between EPE and Average (%)	Gap between EPE and Top Quartile (%)
Steam O&M/ Steam MWh	\$8.4	\$6.4	\$4.7	24%	44%
Nuclear O&M/ Nuclear MWh	\$11.2	\$27	\$12.9	None	None
Total O&M/ Total MWh	\$10	\$7.2	\$4.8	28%	52%

EPE's steam generating units are old and expensive to operate. Staffing levels may be high at several of the gas powered steam units. While there is limited opportunity for EPE to influence Palo Verde costs, it is still a relatively low cost nuclear plant.

**EPE's Transmission O&M cost benchmarks were lower (less expensive) than the peer group average in 2005.**

### *Transmission O&M Benchmarks-2005*

	EPE	Peer Group Average	Peer Group Top Quartile	Gap between EPE and Average (%)	Gap between EPE and Top Quartile (%)
<b>Trans. Operation Cost/Line Mile</b>	\$5,049	\$6,893	\$3,349	None	34%
<b>Trans. Maintenance Cost/Line Mile</b>	\$992	\$1,990	\$1,069	None	None
<b>Total Trans. O&amp;M Cost/ Line Mile</b>	\$6,041	\$8,883	\$4,418	None	27%

EPE benefits from having more moderate weather conditions than other peer group companies (limited ice, limited high winds, etc.), but must maintain many miles of remote line.

## Distribution—2005 Benchmark Summary

**EPE's Distribution O&M cost benchmarks were below (less expensive) than the peer group average in 2005.**

### *Distribution O&M Benchmarks-2005*

	EPE	Peer Group Average	Peer Group Top Quartile	Gap between EPE and Average (%)	Gap between EPE and Top Quartile (%)
<b>Distribution Operation Cost/ Customer</b>	\$33.9	\$34.8	\$28.8	None	15%
<b>Distribution Maintenance Cost/ Customer</b>	\$18.8	\$40.3	\$28.4	None	None
<b>Total Distribution O&amp;M Cost/Customer</b>	\$52.7	\$75.1	\$57.2	None	None

EPE benefits from having more moderate weather conditions than other peer group companies (limited ice, limited high winds, etc.). EPE's distribution reliability statistics reflect system performance well above most of the Peer Group companies.

Source: FERC Form 1, NCI analysis

## Customer Care—2005 Benchmark Summary

**EPE's Customer Care O&M cost benchmarks in the top quartile of the peer group in 2005.**

### *Customer Care O&M Benchmarks—2005*

	EPE	Peer Group Average	Peer Group Top Quartile	Gap between EPE and Average (%)	Gap between EPE and Top Quartile (%)
<b>Cust. Account Expenses/ Customer</b>	\$32.5	\$41.8	\$33.7	None	None
<b>Cust. Svc and Info Expenses/ Customer</b>	\$1.4	\$13.5	\$2.1	None	None
<b>Sales Expenses/ Customer</b>	\$0.1	\$4.0	\$0.1	None	None
<b>Total Customer Care Expenses/ Customer</b>	\$34.0	\$59.3	\$35.9	None	None

EPE ranked high in most metrics in an annual customer satisfaction survey of about 100 utilities.

Source: FERC Form 1, NCI analysis

## A&G– Benchmark Summary

**EPE's A&G O&M cost benchmarks were higher than the average of the peer group in 2005.**

### *Example\* A&G O&M Metrics- 2005*

	EPE	Peer Group Average	Peer Group Top Quartile	Gap between EPE and Average (%)	Gap between EPE and Top Quartile (%)
<b>A&amp;G Salaries/ Customer (920)</b>	\$57.7	\$49.0	\$28.9	15%	50%
<b>A&amp;G Outside Services/ Customer (923)</b>	\$28.9	\$19.7	\$11.2	32%	61%
<b>Total A&amp;G Expenses/ Customer**</b>	\$172.6	\$121.6	\$85.3	36%	51%

A&G costs have been driven by increases in consulting and legal fees, as well as historical accounting practices. A new Oracle System will address the allocation of costs by more appropriately tracking the source of each cost item.

\*Not all A&G accounts are listed here...the third row (Total A&G costs) is therefore not the sum of the first two rows

\*\*Total A&G excludes accounts 926 (Pensions and Benefits); 927 (Franchise Requirements); 928 (Regulatory Commission Expenses)

Source: FERC Form 1, NCI analysis



# **EPE's measured\* O&M costs are “reasonable” given the Company's current structure and operating environment.**

- Overall, EPE's costs are reasonable given the Company's current business structure and operating environment
- Steam unit O&M costs is understandably high because of the age and size most of the units
- EPE's low T&D O&M costs have not harmed reliability figures

\*all costs on this page are the “measured” costs, which exclude the six FERC account items noted on page 10  
Sources: FERC Form 1, EPE 10-K, EPE internal information, NCI analysis

## **EPE's measured\* O&M costs are “reasonable” given the Company's current structure and operating environment.**

- Customer care spending is low, but customer satisfaction numbers (according to the one source EPE uses) are relatively good.
  - Customer expectations are growing - this is an area EPE will likely need to make enhancements to its existing programs to meet expectations
- Relatively high A&G expenses appear to be more of a function of accounting practices and tools than actual “unreasonably” high spending
  - Low distribution and customer care costs “balance out” high A&G costs
  - The new Oracle system should address some of these issues

\*all costs on this page are the “measured” costs, which exclude the six FERC account items noted on page 10  
Sources: FERC Form 1, EPE 10-K, EPE internal information, NCI analysis

- The City and EPE should identify a set of performance measures that EPE can employ to self-report annual benchmark performance to the City to effectively assess EPE's performance compared to an agreed upon Peer Group of companies. This annual activity would facilitate an annual dialogue between the City and EPE to assist the City to:
  - Effectively assess operating cost elements
  - Effectively assess performance and customer satisfaction indices
  - Track EPE performance trends to prepare the City to consider issues to be addressed at the end of the current term of the Rate Agreement

- EPE should take action to address the condition of the old gas-fired steam units being a major cost liability.
  - A logical option to reduce O&M costs is to replace them with new more efficient units (and would also greatly reduce fuel costs).
  - Benchmark generation performance (e.g., forced outage rates; net availability factors) using industry standard practices (“NERC”).

- EPE should develop staffing replacement plans, particularly in the generation function, to address potential retirements.

- EPE should continue to seek opportunities to deploy new systems and technologies to displace manual processes and enhance operational proficiency:
  - GIS
  - Outage Management
  - Customer Information System